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Supreme Court, U.S.
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No. 03-1046

IN THE

Supreme Court of the United States

AT&T CORP.,

Petitioner,

v.

BOBBY GENE ALLEN AND DEBORAH JANE ALLEN,
ON BEHALF OF THEMSELVES
AND ALL OTHERS SIMILARLY SITUATED,

Respondents.

On Petition for Writ of Certiorari to the Oklahoma Court of Civil Appeals

REPLY BRIEF

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REPLY BRIEF

As AT&T explained in its opening brief, the class certification order that the Oklahoma Supreme Court approved in this case violates fundamental principles of state sovereignty and due process. By permitting Oklahoma state courts to exercise jurisdiction over, and apply Oklahoma law to, claims challenging the collection of municipal sales taxes in 27 other States, the decision below interferes with the core sovereign authority of these other States to administer their own tax laws. Indeed, the Multistate Tax Commission, which represents 23 of the affected States *as well as Oklahoma itself*, has filed an amicus brief urging this Court to review the "perverse" decision of the Oklahoma courts, which "impairs . . . legitimate State tax policies" and "directly den[ies] the sovereign interests of sister States." Multistate Tax Commission Br. ("MTC Br.") 2.

The Oklahoma courts' conclusion that it can treat this case as one that does not involve tax refunds does not obviate the constitutional violation; that conclusion *causes* the violation. As the Multistate Tax Commission has confirmed, whatever the rule in Oklahoma, in other States this lawsuit—an action against an involuntary agent who allegedly over-collects taxes that it remits to the State—would be defined as a tax refund action. Some States bar this type of suit altogether, while others require that such a suit be brought only after administrative remedies are exhausted, or only in certain courts. The class certification order entered in this case unconstitutionally interferes with the judgments of these other States, and no effort to distinguish cases on their specific facts can obscure this fundamental violation of state sovereignty.

Nor is there any merit to respondents' finality argument. This case falls within a well-recognized exception to the final judgment rule. In fact, the finality rule is rooted in principles of federalism and respect for the sovereign rights of States—

the very same principles Oklahoma's courts violated in this case. Respect for one State's judicial processes should not shield from review a decision that intereferes with the processes and legislative judgments of 27 other States.

1. This case squarely presents the federal issue of whether a state court can entertain a suit by non-residents challenging an alleged over-collection of local taxes, when the States in which those plaintiffs reside prohibit such suits. Contrary to respondents' central claim, the Oklahoma courts necessarily—and incorrectly—resolved this legal issue. Whether this suit is a prohibited tax refund action is not "a mixed question of fact and law" to be resolved on the basis of testimony. Opp. 2. It is a legal determination that must be made under the laws and policies of each State in which particular taxpaying class members reside. And several of the States in which class members reside have concluded that this precise type of lawsuit *is* an improper tax refund action.

Indeed, the Oklahoma Court of Civil Appeals itself expressly recognized that other States treat lawsuits against vendors for alleged over-collection of taxes as tax refund actions. Pet. App. 4a-5a (citing *P.R. Mktg. Group* v. *GTE, Fla., Inc.*, 747 So. 2d 962 (Fla. Dist. Ct. App. 1999), and *Serna* v. *H.E. Butt Grocery Co.*, 21 S.W.3d 330 (Tex. App. 2000)). In *Serna*, the Texas court concluded that, under Texas law, any suit "claiming [that] taxes were collected in an amount greater than the legal rate[] *actually amounts to a suit for a tax refund*." 21 S.W.3d at 335 (emphasis added). Like respondents here, the plaintiff in *Serna* argued that a suit seeking "damages" from a vendor for the allegedly unlawful collection of excess sales taxes was not a suit for "a refund of a sales tax," *id.* at 332, but the court squarely rejected that claim. "[P]ermitting a party to cloak a suit under a different cause of action, in order to seek redress from the agent who collects the tax (and who no longer holds the funds in question)" would impermissibly thwart Texas statutes

designed to protect vendors and promote "the fair and efficient administration of the Texas sales tax." *Id.* at 334-35.

Similarly, in *P.R. Marketing Group*, the Florida court concluded that, under binding state precedent, customers could not sue either the vendor who "collected more sales tax than the law allows" or the state agency that received those excess taxes without exhausting certain administrative remedies. 747 So. 2d at 962, 964. In *Davidson* v. *Rochester Tel. Corp.*, 558 N.Y.S.2d 1009 (App. Div. 1990), the New York court held that plaintiffs could not bring an "unjust enrichment" claim against a telephone company for overcollection of sales taxes; the taxpayers' sole recourse was to sue the State for a refund, after exhausting administrative remedies. *Id.* at 1011. And a Pennsylvania court concluded that Pennsylvania's tax code precluded a fraud action based on over-collection of taxes. *Heaven* v. *Rite Aid Corp.*, No. 0596, 2000 WL 33711049, at *5 (Pa. Ct. Com. Pl. Oct. 27, 2000).[1]

These cases make clear that, unlike Oklahoma, other States would regard this lawsuit as a tax refund action. More fundamentally, these cases demonstrate that the Texas, Florida and New York residents who are members of the class in this case are, by virtue of the certification order, bringing direct actions against AT&T for over-collection of local taxes that their home States *do not allow those residents to bring.* That order is thus a direct affront to the sovereign rights and interests of these States.

None of the factual distinctions respondents offer can obscure or minimize the impropriety of that affront.

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[1] Although respondents object to citation of this decision, Op. 22-23, AT&T does not rely on the case for its precedential value, but as evidence that Pennsylvania's tax laws have been applied in the same manner as the tax laws of other States. Indeed, the Multistate Tax Commission, which represents Pennsylvania, has confirmed that Pennsylvania requires claims implicating taxes to be brought against the State itself. MTC Br. 6.

Respondents make much of the fact that the plaintiffs in *P.R. Marketing Group* sued the state taxing authority and sought refunds directly from the state treasury. Opp. 20. But the plaintiffs in that case also sued the vendor, and the court held that they could not proceed with *any* of their claims because they had not exhausted administrative remedies.

Respondents' suggestion that *Davidson* is distinguishable because the plaintiff in that case "sought tax refunds directly from the" State, Opp. 20, is wrong. Davidson "ma[de] no claim against the State." *Davidson*, 558 N.Y.S.2d at 1011. Respondents' assertion that Davidson "did not assert that the phone company's conduct was wrongful," Opp. 20, is also incorrect. Like respondents here, Davidson alleged that the "collection of sales taxes was 'improper, unnecessary, unauthorized by law, and . . . an unjust enrichment.'" *Davidson*, 558 N.Y.S.2d at 1011 (omission in original). And, like respondents here, Davidson did not challenge the "validity" of the tax but its applicability, arguing that the specific service (like the specific non-municipal residents here) was not subject to the tax in question. *Id.*

Nor can respondents distinguish the decision in *Serna*, which held that Texas citizens cannot sue vendors at all for over-collection of taxes. Neither *Serna* nor the statutes cited in that case recognize any exception for citizens who have "ongoing contractual relationship[s]" with vendors or who seek injunctive relief in addition to damages. Op. 21. Respondents' suggestion, *id.* at 21-22, that *Serna* was modified by *Alford Chevrolet-Geo* v. *Jones*, 91 S.W.3d 396 (Tex. App. 2002), is utterly baseless. The vendors in *Jones* defrauded consumers into paying taxes that the *vendors* owed. In stark contrast to *Serna*, *P.R. Marketing Group*, *Davidson* and this case, therefore, the State did not receive any of the contested payments; the windfall went to the vendors, who had larger after-tax profits than they would have enjoyed had they paid their obligations to the State with their own funds instead of money they bilked from customers. In allowing the

victims of this fraud to sue, *Jones* did not alter the rule that vendors cannot be sued for *collecting and remitting* taxes in an allegedly erroneous amount.

As the Multistate Tax Commission has explained, Texas, Florida, New York and other States whose residents were certified as part of the class prohibit suits like this or require exhaustion in order "to enhance the efficient functioning of state tax systems." MTC Br. 2. These rules promote "willing cooperation from those responsible to collect and pay over" taxes, "safeguard [the States'] fisc," "protect[] the court system from needless litigation," and ensure that tax disputes are resolved by those who are "familiar with the intricacies of tax laws." *Id.* at 2, 6. While Oklahoma is free to decide that these policies should not bar a suit by its citizens for over-collection of state or local taxes, it cannot make that decision for any other State. Yet that is precisely what it has done here.

Indeed, in concluding that the trial court had jurisdiction to certify a multi-state class, the Court of Civil Appeals stressed that the primary purpose of respondents' suit was to obtain injunctive relief, Pet. App. 7a; see also Op. 19-22. As the policies behind the federal Tax Injunction Act, 28 U.S.C. § 1341, attest, however, such relief is the most severe interference with "'the imperative need of a State to administer its own fiscal operations.'" *Franchise Tax Bd.* v. *Alcan Aluminium Ltd.*, 493 U.S. 331, 338 (1990). Respondents try to brush aside this violation of state sovereignty by blithely asserting that no State permits imposition of municipal taxes on those who reside outside the municipality. Op. 7. But error-free tax collection is simply not possible in light of the enormous complexity and expense of the activity. See Council on State Taxation ("COST") Br. 6-8. Accordingly, the class certification order in this case creates strong incentives for businesses to under-collect taxes in order to avoid damages liability, see *id.* at 8-9—the very incentives States like Texas, Florida, New York and others

seek to prevent by, among other things, barring direct suits against vendors for over-collection of taxes.[2]

Similarly, while Oklahoma is free to decide for itself that administrative remedies need not be exhausted in a case such as this, other States have made a contrary determination. In *P.R. Marketing Group* and *Davidson*, the courts weighed the very same practical burdens and problems that the court below identified, but concluded that exhaustion was still required. See *P.R. Mktg. Group*, 747 So. 2d at 964-65; *Davidson*, 558 N.Y.S.2d at 1012 (Yesawich, J., dissenting) (identifying problems). By certifying a class that includes Florida and New York residents, the Oklahoma courts have directly impaired the sovereign rights of other States to manage their own fiscal operations.

In short, the certification order in this case squarely raises a fundamental federal question concerning the duty of one State to respect the sovereign taxing prerogatives of sister States. And Oklahoma's determination that it can adjudicate claims challenging a vendor's alleged over-collection of taxes in other States conflicts with the decision of the highest court of New York, which has recognized that "[f]or our tribunals to sit in judgment on a tax controversy between another State and its present or former citizens would be an intrusion into the public affairs of another State." *City of Phila.* v. *Cohen*, 184 N.E.2d 167, 169 (N.Y. 1962). Once again missing the doctrinal forest for the factual leaves, respondents argue that *Cohen* only addressed whether New York courts were *required* to hear a tax suit brought by another State. Op. 12-13. But *Cohen* deemed it an "intrusion" to hear claims involving another State's taxes even when the other State *wanted* New York to do so. It follows *a fortiori* that New

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[2] These incentives, moreover, completely belie respondents' simplistic claim that the order in this case will "not impact any state's ability to collect taxes." Op. 6.

York would not entertain a suit challenging the collection of taxes in other States when those States *prohibit* such suits.

Even without this conflict, however, this case warrants review. This Court recently granted certiorari in the absence of any split in authority in order to review an isolated decision that merely chilled California's ability to conduct residency audits as part of its tax enforcement efforts. See Petition for Writ of Certiorari, *Franchise Tax Bd.* v. *Hyatt*, No. 02-42 (U.S. filed July 2, 2002) ("California Petition").[3] The decision in this case is not an isolated problem; an Illinois court recently upheld a multi-state class certification order that violates the sovereignty of other States in precisely the same manner as the order in this case. *P.J.'s Concrete Pumping Serv., Inc.* v. *Nextel W. Corp.*, 803 N.E.2d 1020 (Ill. App. Ct. 2004). Moreover, the orders in this case and in *Nextel* have far greater and more immediate adverse impacts on the sovereign right of States "'to administer [their] own fiscal operations,'" *Alcan Aluminium*, 493 U.S. at 338, than was true in *Hyatt*. These orders do not merely chill ancillary enforcement efforts, they permit over-collection suits that other States bar, and create perverse incentives for the under-collection of taxes. The decision in this case plainly warrants review in this Court, the only Court that can prevent these fundamental harms to the sovereign interests of other States.

2. Respondents' attempt to show that the decision in this case is consistent with the due process requirements set forth in *Phillips Petroleum Co.* v. *Shutts*, 472 U.S. 797, 811-12 (1985), fails for essentially the same reasons. Respondents rely on the same boot-strapping premise that this case is not a tax refund action. Opp. 15-17. Not only is this contention wrong, see *supra* 2-3, it is irrelevant. Due process prohibits Oklahoma from applying its substantive law to claims

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[3] California's petition cited only two lower court state decisions involving cooperative federalism principles in two non-tax cases. *See* California Petition at 12-14.

involving taxes, taxpayers and transactions entirely beyond its borders, regardless of the nature of those claims.

Nor is it true that there is no "material conflict" between Oklahoma's law and that of the 27 other affected States. Op. 17-19. Texas, New York and Florida may all recognize a general "futility" exception to their administrative exhaustion requirements. But both Texas and New York flatly prohibit direct actions against vendors for over-collection of taxes, whether or not administrative remedies are exhausted. See *supra* at 2-3. And Florida has squarely held that its exhaustion requirement applies in precisely the circumstances presented here. *Id.* at 3. Finally, the fact that respondents seek injunctive relief does not obviate the constitutional infirmity of the class certification order. Op. 19-22. Enjoining the collection of taxes in other States based on the extraterritorial application of Oklahoma law directly interferes with the sovereign rights and prerogatives of those States.

3. Unable to defend the constitutional propriety of the order in this case, respondents seek to shield it from review. They stress that the decision of the Court of Civil Appeals is unpublished and thus is not binding precedent. Op. 1, 3, 5. But this Court has not permitted publication status to insulate intermediate state court decisions from review where, as here, those decisions clearly violate federal law. See, *e.g.*, *Perry* v. *Thomas*, 482 U.S. 483, 488-89 (1987) (reviewing and reversing unpublished, interlocutory decision in which intermediate state court refused to compel arbitration in accordance with federal law); see also *Smith* v. *United States*, 502 U.S. 1017, 1020 n.* (1991) (Blackmun, O'Connor and Souter, JJ., dissenting) ("Nonpublication must not be a convenient means to prevent review"). Whether or not the decision of the Court of Civil Appeals must be followed by other Oklahoma courts in the future, that decision necessarily harms the sovereign rights of other States.

Nor does the interlocutory nature of the decision preclude review. The Oklahoma Supreme Court has decided, by a 5-4

vote, that Oklahoma courts can entertain over-collection suits brought by non-resident taxpayers whose own States prohibit those very claims. This Court has repeatedly reviewed interlocutory state court decisions in cases, such as this one, where the federal issue is whether state courts have the power to entertain certain claims at all. See Pet. 3 (describing cases); see also *Perry*, 482 U.S. at 488-89. In this case, moreover, "a refusal immediately to review the state court decision" will not just "seriously erode federal policy." *Cox Broad. Corp.* v. *Cohn*, 420 U.S. 469, 483 (1975). Where, as here, non-residents are barred from suing vendors for alleged over-collection of taxes, the very act of permitting such suits violates the sovereign rights of other States and the principles of cooperative federalism that underlie our system of government. Where interlocutory decisions cause immediate harms to important federal interests, this Court does not postpone review while the merits are improperly addressed. See, *e.g.*, *Perry*, 482 U.S. at 488-89; *Southland Corp.* v. *Keating*, 465 U.S. 1, 6-8 (1984); *Local No. 438 Constr. & Gen. Laborers' Union* v. *Curry*, 371 U.S. 542, 546-50 (1963).

Indeed, there is a very real danger that the interests of affected States will never be vindicated if review is denied now. Large class actions create enormous pressures for defendants to settle rather than risk massive damages awards. AT&T has neither all of the incentives nor all of the resources that a State would have to litigate this case to a final judgment. Yet the States will be directly harmed by a settlement, which will create strong incentives for other vendors to resolve all good faith doubts in favor of under-collection, given the comparative risks of under-collection versus over-collection of state taxes. See COST Br. 8-9.[4]

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[4] By contrast, there is little chance that non-residents will ever be excluded from the class. While certification orders can be amended, the question of including non-residents in the class has been decided as one of jurisdiction, not one of class definition. Indeed, the trial court has "repeatedly rejected" AT&T's jurisdictional argument, Op. 8, insisting

It would be particularly inappropriate for this Court to countenance such impairments of the sovereign interests of numerous States based on the finality requirement of 28 U.S.C. § 1257. The final judgment rule itself is rooted in principles of federalism that compel respect for the sovereign rights of States. But these very principles have been violated by Oklahoma's approval of the class certification order in this case. A statute designed to ensure federal court respect for state judicial processes should not shield from review a state-court decision that intereferes with the judicial processes and sovereign legislative judgments of 27 other States. Because the final judgment rule does not stand as a barrier to this Court's review of interlocutory state-court decisions that violate federal arbitration and venue policies, see *Perry*, 482 U.S. at 488-89; *Southland Corp.*, 465 U.S. at 6-8; *Mercantile Nat'l Bank* v. *Langdeau*, 371 U.S. 555, 558 (1963), it cannot preclude review of an interlocutory decision that "impairs . . . legitimate State tax policies" and "directly den[ies] the sovereign interests of sister States." MTC Br. 2.

Finally, immediate review will not result in any inefficiency or undue expense. Op. 5. While such review will not terminate litigation by Oklahoma taxpayers, it will end litigation on causes of action that non-residents have no right to bring and that Oklahoma courts cannot entertain, and thus will significantly simplify the litigation and eliminate the need for further proceedings following this Court's review of a final judgment. In all events, considerations of judicial economy must yield where, as here, an interlocutory decision creates an intolerable risk of interference with the core sovereign rights of other States.

CONCLUSION

This Court should grant the petition for a writ of certiorari.

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that it is "law of the case." Pet. App. 47a. Respondents do not suggest how the issue could even arise again in any subsequent proceedings.

Respectfully submitted,

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